No. 12338

In The United States Court of Appeals
For the Ninth Circuit

NORTHWESTERN MUTUAL FIRE ASSOCIATION,
Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Appellee.

UPON APPEAL FROM THE TAX COURT OF THE UNITED STATES

REPLY BRIEF OF APPELLANT

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A. MUTUALS NOT TAXED IN CANADA ON INVESTMENT INCOME

Referring to Canada, appellee states (p. 7): "It just did not impose an income tax upon the investment income of mutual insurance companies, or upon any other income of such companies in 1942 and 1943 though it did later in 1946." That is not true. In 1946 Canada did not impose a tax upon the investment income of appellant. Though the Income War Tax Act was amended in 1946 the tax on mutuals such as appellant was not imposed until 1947. Then it was NOT imposed upon their investment income, but upon their net income excluding their investment income. Arguendo, if the "gross amount of income tax" imposed upon appellant under the Internal Revenue Code is "an income tax" then Canada did impose "an income tax" on "other income" of appellant, namely, on its "net premium income."

B. APPELLANT'S U. S. TAX BASE WAS GROSS INCOME

In 1942 and 1943 appellant *was not* subject, under Section 207 I.R.C., to a federal income tax *imposed upon its entire investment income* derived both from sources in the United States and Canada. That statement is misleading. Appellant was "*subject to*" a federal income tax "*imposed upon*" its "*gross amount of income*" from sources in the United States and Canada under Section 207 (a) (2) I.R.C. (Tr. 18, 19, 56, 57). Its "gross amount of income" *included* its "entire investment income," but its "investment income" was a negligible factor. As pointed out in appellant's brief (page 37) 97% of appellant's gross amount of income consisted of "net premiums"—not more than 3% consisted of "investment income."

It is not true that "a normal-tax" of 30% was imposed upon the company's "normal-tax net income." *If the Internal Revenue Code had* imposed a tax on such basis its normal tax would have been 24% (*not 30%*) upon its "normal-tax net income" and a surtax of 14% (*not 20%*) upon its surtax net income. But such tax was not imposed upon appellant. During those years Section 207 (a) (2) imposed upon appellant a tax of 1% on its "gross amount of income" (Tr. 18, 19, 56, 57).

Appellee states that Section 207 (a) (2) imposes a tax of 1% "upon the 'gross amount of income' *exceeding $75000* * * *." That is not true! Under that section if the gross amount of taxpayers' income exceeds $75,000 the tax of 1% is imposed upon its entire

"gross amount of income," not, as appellee states upon the amount in excess of $75,000.

C. NO CASE HOLDS CANADIAN TAX A PRIVILEGE TAX

Referring to the Canadian Special War Revenue Tax appellee states: "This tax has been held to be a business privilege or franchise tax rather than an income tax * * *." The cases cited *do not* so hold! In the case of *Continental Insurance Co. v. Commissioner* (1939) 40 B.T.A. 540, quoted by the Tax Court in this case, the Board of Tax Appeals *held* that the Canadian Special War Revenue tax *was not* an "income tax" within the meaning of Section 131 (a) (1) of the Revenue Act of 1934. In its decision it stated: "It was *more like* an excise tax upon the privilege of doing business *than like* an *income tax.*" That is not a holding that it *was* a business privlege tax, and in any event is dicta. The holding of the Federal District Court in the case of *St. Paul Fire and Marine Insurance Co. v. Reynolds* (1942) 44 F. Supp. 863, 865, was to the same effect: "The premiums received were not income within the meaning of that term as used in Section 131 (a) (1) of the Revenue Acts (1933, 1934, 1935 and 1936) and the premium tax was not an income tax." By way of dicta the federal court also observes that the Canadian tax is *more like* an excise tax than an income tax (based on profits) but it does not specifically so hold. In the case of *Helvering v. Queen Ins. Co.*, 115 F.2d 341, the taxpayer conceded that the Canadian Special War Revenue Tax *was not "an income tax"*

F. CONGRESS INTENDED TO ALLOW CREDIT FOR TAX ON GROSS INCOME

Appellant agrees that the limitation feature of Section 131(b)(1) continues to apply to limit the amount of taxpayers' foreign tax credit as therein provided (See Appellant's Brief, Section G, pp. 77-86). Appellant does not agree (page 16) that "* * * to carry out the Congressional intent, what we must look for is a Canadian tax based upon investment income, however measured * * *."

Appellees goes ahead to say "* * * for example, as a tax upon gross investment income, or a tax upon the doing of an investment business, or a tax upon the holding of investments measured by their value * * *." If, to qualify as a credit under 131(h), Congress intended that the foreign tax had to be based upon "investment income" why was Section 131(h) added to the Internal Revenue Code? A tax based on investment income could qualify for a tax credit prior to 1942 under Section 131(a)(1) of prior revenue laws. Appellee disregards the facts. The taxpayer in this case is engaged in the insurance business (Tr. 24, 50), not in the investment business. Its investment income was a negligible factor in its taxable income under U.S. law (Appellant's Opening Brief, Appendix No. XI, p. A-13). The basis of its tax in this country was its "gross amount of income" (Tr. 18, 19, 56, 57, Appellant's Opening Brief, Appendix No. XI, p. A-13) *not* its investment income. The facts conclusively indicate that Congress intended Section 131(h) to permit a foreign tax credit where the foreign tax was measured by "gross income, gross sales or

number of units produced within the country * * *" (Tr. 39). The standard suggested by appellee is contrary to the expressed intent of Congress.

G. CONGRESS DID NOT INTEND ADMINISTRATIVE DIFFICULTIES TO BE A CONDITION PRECEDENT TO GRANT OF CREDIT

Appellant's reference to Treasury Regulation 103 was *not* inadvertent! It was intentional. Appellant's reference (Appendix No. IX p. A 10) was to Treasury Regulation 103 as amended by T. D. 5226, 1943-4-71350 approved February 10, 1943. Treasury Regulation 111, Sec. 29, 131-2, is a comparable regulation issued in 1944. From it appellee argues that "the administrative difficulties a foreign country might have in determining net income" is a *sine qua non* to the granting of a foreign tax credit under 131 (h).

It is not an essential prerequisite according to the expressed intent of Congress (Tr. 39). The Senate Finance Committee stated in part: "Thus *if* * * * for reasons growing out of the administrative difficulties of determining net income * * *." The words *are not*, as contended by appellee, *definitive* of the conditions under which the credit can be granted, but are purely *illustrative* as their context clearly shows.

H. IN LIEU OF TAX MUST BE AN EXCISE TAX

Appellees' reference (page 18) to "the grant of credit on account of a *foreign excise* tax levied on mutual insurance companies" is inapt. By definition an "excise tax" is "any duty, toll or tax." Webster's New International Dictionary (unabridged).

In the modern sense it has been repeatedly held to be "any tax not falling within the classification of a poll or property tax." *Diefendorf v. Gallet* (1932) (Idaho) 10 P. (2d) 307, 312; 51 Am. Jur. 61, §33, and cases cited therein. Any tax imposed by a foreign country in lieu of an income tax would necessarily be an excise tax by definition, unless it was a poll or property tax.

I. SECTION 207(a)(2) I.R.C. DOES NOT IMPOSE AN EXCESS TAX

Appellee's statement (pages 18 and 19) that the so-called alternative "special tax" imposed upon appellant under Section 207 (a) (2) imposed only an "excess tax" over and above the amount of tax imposed under Section 207 (a) (1) is a gross misstatement of the law. (See Appellant's Opening Brief Appendix No. II p. A 3.) The law states in part: "There shall be levied, collected and paid * * * upon the income of every mutual insurance company * * * a tax computed under paragraph (1) OR paragraph (2) *whichever is the greater* * * *" (Emphasis supplied). It is not an excess tax. Neither is it an alternative tax. The provision is too plain to require further elaboration.

Appellee argues that the "so-called excess" was deliberately disregarded by Congress in fixing the limitation of credit under Section 131 (b). Appellant agrees! Congress examined the provisions of Section 131 (b) in 1942, found them adequate and therefore did not change them.

J. APPELLANT'S NET PREMIUMS TAXED IN BOTH CANADA AND U. S.

Appellee makes some pertinent observations and admissions (page 19) that will bear emphasizing. Section 207(a) (2) I.R.C. and Section 131 (h) I.R.C. were both enacted in 1942. Appellee admits that if the House amendment to 207 had passed, appellant would be entitled to claim the credit under Section 131 (h). Why this admission? It is because the House amendment tax included "net premiums" which were similarly defined in the Canadian Act. Section 207 (a) (2) I.R.C. also includes "net premiums" which, in Section 207 (b) (2) are similarly defined in the Canadian Act. They are the same "net premiums" on which appellant was subject to tax in 1942 and 1943 in both Canada and the United States. Appellee gives no convincing argument why that is not the "double taxation" against which Congress intended to grant relief when it expanded Section 131 I.R.C. by the addition of subsection (h).

K. THE COMMISSIONER'S TEST IGNORES THE 1942 AMENDMENT ADDING SUBSECTION (h) TO 131 I.R.C.

Appellee asserts (page 20) "* * * nowhere is there the slightest indication that Congress intended by Section 131 (h) to permit the inclusion in the credit base of anything but 'normal-tax net income,' or to allow the credit to be taken on account of a foreign tax which was not levied in respect of such base." That fairly summarizes appellee's argument. If the foreign tax is not on "normal tax net income" it can-

not qualify as a foreign tax credit. That was the Commissioner's argument prior to the 1942 amendment of Section 131 I.R.C. That is his argument now after the addition in 1942 of subsection (h) to Section 131 I.R.C. Appellee does not dispute appellant's argument that Section 131 was originally enacted to mitigate the evil of double taxation. Appellee does not deny that subsection (h) was added to broaden the basis for allowing foreign tax credits so that that section might thereby carry out more effectively its salutory purpose. Prior to 1942 a foreign tax based upon "normal-tax net income" was allowed as a foreign tax credit under Section 131 (a) (1). If Congress did not intend to allow a foreign tax as a credit unless it was based upon "normal-tax net income," why did Congress bother to add subsection (h) to Section 131? The intent of Congress as expressed by the Senate Finance Committee which sired the amendment which added subsection (h) was to permit a foreign tax credit *even though* the foreign tax *was not* based on taxpayer's "normal-tax net income"—even though the foreign tax was based upon taxpayer's "gross income, gross sales or number of units produced in the country" (Tr. 39). Appelle's conclusion quoted above does not answer part III (b) of appellant's brief pp. 27-31.

L. CREDITS ARE NOT THE SAME AS DEDUCTIONS AND EXEMPTIONS

The cases cited by appellee all deal with exemptions or deductions. Not one applies the rule quoted to a claim of credits against tax. There is a distinction:

> "Deductions and exemptions are two separate and distinct things, having no connection. A deduction is the taking of the subtrahend from the minuend; it is a subtraction. Exemption is an immunity or privilege; it is a freedom from a charge or burden to which others are subject."
>
> *Florer v. Sheridan* (1894, Ind.) 36 N.E. 365, 369.

The U. S. Supreme Court recognized and emphasized the distinction between "credits" and "deductions" in the case of *Burnet v. Chicago Portrait Co.* (1932) 285 U.S. 1, 15, 76 L. ed. 587, 10 A.F.T.R. 800, where in discussing the change in the U. S. Internal Revenue Code from allowing foreign taxes as a "deduction" to allowing them as a "credit" Chief Justice Hughes stated:

> "*The distinction made* with respect to income taxes paid to the States of the Union, and their political subdivisions, *between deductions from gross income and credits against taxes*, simply reflects the economic policy adopted in making allowances for taxes paid within the borders of Continental United States and the organized territories. In *relation to income taxes paid outside these borders the provision as to credits was enacted to give greater and not less relief* * * *." (Emphasis supplied)

Since appellant is not claiming an "exemption" or a

"deduction" but a "credit" appellee's authorities are not in point. In any event appellant has cited the applicable statutory provision which entitles it to the credit claimed, and has clearly shown its right to come within the terms of that section.

M. AN OBJECTIVE TEST FOR RELIEF UNDER SECTION 131(h) I.R.C.

Appellee fails to answer with authorities the main points of appellant's argument. No constructive suggestions are made for an objective test, to be applied, to determine the allowability of a foreign tax credit under Section 131(h)IRC. Appellant, therefore, suggests the following objective test:

Is the tax one imposed by a foreign country on a basis other than net income where the taxpayer (exempt from payment of a net income tax) is subject to a tax measured substantially by gross income, gross sales or number of units produced within such country?

The proposed test embodies all of the essential prerequisites set forth in the law, and the report of the Senate Finance Committe which amended the law. Its application will carry out the intent of Congress in enacting the amendment.

N. CONCLUSION

If applied in this case appellant is clearly entitled to the credits claimed. Indeed in appellee's brief there is not one argument, supported by authority, that answers or in any way refutes the arguments in appellant's opening brief. For the reasons set forth therein appellant is entitled to the foreign tax credits claimed. Appellant is entitled to judgment reversing the decision of the Tax Court and awarding it foreign tax credit refunds claimed.

Respectfully submitted,

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